Incentive compensation:
a three-step process to sales force success

Management has long neglected incentive compensation, yet such schemes can help guide reps to the right customers, product and markets. When did you last review your incentive plan?

In the past, incentive compensation (IC) schemes have often been repeated year after year and been subjected to very little scrutiny by management. In Europe they may actually have been undervalued. Well-designed IC can, however, show the way forward by offering the essential routemap to guide reps to the right customers, products and markets.

STEP 1 - DIAGNOSIS
Doing nothing about IC is no longer an option. At IMS Health we believe IC review is fast becoming a hot topic.

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CHANGE CHARACTERISTICS
We see forces of change gathering which will impact on the high level design of incentive reward schemes. But the scope and intensity of these changes are unfortunately not universal or uniform in all countries, which further distorts the picture.
Partly in response to these changes, we are also seeing a number of sales force innovations in pharma. These include:
- The development of team-based selling and account teams, in part driven by the growing influence of central bodies such as the UK’s NICE and Primary Care Trusts, and Germany’s IQWiG and sick funds
- A growing interest in qualitative measurements of the perceived value of industry to customer interaction, as well as the strength of this relationship
- The need for more measurement of adherence to all forms of compliance and company-initiated ethics programmes
- Field force adoption and utilisation of supportive technologies such as CRM and closed loop marketing.
Compensation schemes that recognise these innovations and the changing marketplace will represent the new best practice and help position organisations for continued success in the future.

SUCCESS CRITERIA
Successful compensation systems will help not only strengthen the position of the company in its marketplace and align with the overall business strategy and brand objectives, but also motivate the sales force, retain the most capable sales practitioners and be readily understood by all.

The focus of investment in sales force effectiveness initiatives appears to be moving away from issues around the appropriate size and structure of sales teams towards how to encourage the sales team, and the individual rep, to deliver improved results.

Such a qualitative optimisation programme is increasingly driven centrally, in particular by European-based headquarters with central brand strategies and strategic goals to meet. This means that training and development, as well as frameworks and guidelines for incentivisation plans, are being increasingly drawn into the centre. As a result, corporate headquarters that up to now may have allowed affiliate companies’ flexibility and autonomy in this area, are increasingly aware of a range of different incentive programmes across their businesses and are seeking to normalise these and/or spread best practice by issuing tighter, more refined guidelines.

Successful IC planning will always be built around a feedback loop of continuous process improvement. The first process step - the diagnosis of the existing plan - is designed to provide a fast and unbiased evaluation of its current status with stakeholders and to highlight possible improvement areas [Figure 1].

In the diagnosis phase, the IC plan is assessed against various attributes including:
- **Strategic alignment**: are the key results areas reflected in what gets rewarded?
- **Desirable sales force behaviours**: does the plan design generate the right set of behaviours in the sales force, eg, does it lead to ‘good quality’ calls or to many short calls?
- **Rewarding high vs low performers**: if an IC plan fails to reward high performers significantly above low or
average performers then low/average performers are more likely to be attracted to that organisation.

- **Fairness**: is the plan ‘fair’? High sales force churn driven by perceived inequities in plan design or goal-setting increases cost and leads to low morale.
- **Efficient administration**: is too much effort/cost needed to create management reports? Inefficiencies mean too much overhead.
- **Over and underpayments**: does the process result in errors leading to overpayments which add large financial risk to budgets? Are large numbers of reps and sales managers complaining about the scheme?

### INDEPENDENT DIAGNOSTIC REVIEW

Although the diagnostic phase of the review could be handled in-house, there is a strong case for using an independent third-party to evaluate its current state. Feedback from reps, gathered in confidence by a third party paying due regard to the sensitivities usually at play in this area, is likely to produce a complete picture of the current situation and the state of sales force morale. Using an evidenced-based consultancy with a track record in this area also provides the opportunity to benchmark results against unpublished external data collected from similar organisations around the world. The independent, unbiased and complete nature of the data gathered and analysed can then become a powerful enabler of change within the client organisation [Figure 2].

Through a planned and thorough 360 degree diagnostic review, such as the one described, executives will achieve a good understanding of the current state of the incentive scheme and be able to respond with greater confidence to actionable recommendations on how to improve it.

### KEY DIAGNOSTIC STEPS

The initial step involves gathering four different types of planning data – including personal feedback from reps and other stakeholders – that will help diagnose the current plan and give insights into what works, what is broken and where there are opportunities for improvement [Figure 3]. This ‘unified’ approach brings quantitative and qualitative data together to provide an overview of the situation.

Having gathered the data, the next step is to assess the current plan to measure its accuracy and overall fairness.

### 3. SOURCES OF PLANNING DATA

- **Client sales strategy**
  - Corporate business plan
  - Sales strategy
- **Current data and compensation plan**
  - Total payout
    - by territory
    - by product
  - Payout level
  - Performance metrics
    - by units
    - by currency
    - by scripts
- **Business plan**
  - Eligibility rules
  - IC documentation
  - Product weights
  - Thresholds and accelerators
  - Absolute vs relative
  - Guarantee bonus
  - Time frame guarantee bonus
- **Qualitative feedback**
  - Primary research to gather feedback from reps/field managers/sales exec/sales ops/brand managers
From this we will discover, for example, the number of reps who receive too little or too much payout because of calculation errors; whether there is a level playing field across all the territories and product areas or whether there is an unintentional inbuilt bias; if the distribution of payouts follows expected patterns; and if there is a clear link between performance and payout. In short, we will have a good view of the efficacy of the plan and be well-placed to recommend any improvement options.

**PAYBACK**

There are substantial gains and avoidable losses resulting from a properly administered IC plan. Furthermore, where the design of the scheme is improved to turn lost opportunities into new business, the potential revenue gain can be as much as 5 per cent of sales.

**STEP 2 - DESIGNING THE PLAN**

Among other business critical objectives, IC plans are designed to help deliver the strategy; ensure the successful launch of a vital new product, drive the right behaviours, reward high performance and retain talent.

A plan is typically designed to meet the objectives from a new product launch - to drive initial sales and penetration. Over time, as the product matures and as competitors or generics enter the market, companies may find that they need to turn away from incentivising top-line sales growth of this product to preserving their market share and staving-off competitors. The implication is that companies may therefore need to change how success is measured and what behaviours are rewarded by the plan.

As each product in a portfolio may have its own associated IC plan, remuneration packages may, over time, become very complex and detract from the need to provide clarity of plan design to the sales force. This lack of clarity will be compounded if the company’s communications to the sales force about IC is also less than satisfactory.

**BEST PRACTICE - 4 STEP IC PLAN DESIGN**

The diagnostic phase typically provides the baseline for improvements moving forward and answers the following questions:

- Is the plan perceived by reps to be fair?
- Is the plan aligned with corporate goals/objectives?
- Is the plan too complex for reps to understand?
- Does the plan have the right pay level relative to performance?
- Are high performers adequately compensated?
- Is there inherent bias in the plan?

The plan design phase creates and optimises all plans and aligns them to product strategy [Figure 4]. At IMS we split this phase into designing the plan itself and then goal-setting. This activity is supported by work around agreeing the complete set of ‘eligibility rules’ - an important lever to ensure the payout is applied appropriately - and designing ‘contests’ and special incentive programmes aligned with

**4. FOUR-STAGES OF THE NEW IC PLAN**

1. **Situation analysis and definition of requirements**
   - Structure of the current plan
   - Data gathering
   - Perception of the current plan (management and sales force)
   - Understanding of the selling process and the sales strategy
   - Goals, constraints and requirements for the new plan

2. **Design of options**
   - Discussion of potential options
   - First selection of plan options
   - Decisions on
     - Pay mix*
     - Components of the new plan
     - KPIs for measurement
     - Percentage of incentivised reps
     - Spread of bonuses
     - Options, to be analyzed deeper in the next step (2-3 options)

3. **Testing of options**
   - Per analyzed option (under usage of simulations with historical and forecasted data):
     - Fulfillment of goals, constraints and requirements
     - Real percentage of incentivised reps
     - Real spread of bonuses
     - Differences in payouts against the status-quo on summary level, performance levels and individual levels
     - Check, if the differences make sense in the eyes of client

4. **Decision on plan and implementation**
   - Decision on new plan based on earlier steps
   - Documentation of plan
   - Decision on the future operation of new plan
   - Decision on checkpoints for new plan
   - Compilation of sales force handbook
   - Discussions with workers councils/ unions, where necessary

*where not fixed by legislation or other formal restrictions
new market situations or short-term actions, and ‘award schemes’ that provide longer-term incentives.

Step two is about designing the plan structure. This has three major components: the pay level/mix; the type of plan; and the desired performance criteria. In many EMEA countries like France, Germany and Italy the pay mix is very difficult to change therefore it is very likely that this part will be left out.

By pay mix we mean how total remuneration is broken down into its constituent elements of salary and bonus, and the potential size of the bonus available for exceptional performance [Figure 5].

The right pay mix depends on many factors including the status of each product, the composition of the product portfolio and market dynamics. Reading the market for a product wrongly can leave companies exposed to a high level of financial risk – particularly if bonuses are uncapped and too many reps get too much bonus because it was easier to achieve target than had been expected when the plan was designed.

One particularly interesting discussion that occurs at Step two in the design process focuses on how companies decide to spread the bonus. Sometimes they may want to engineer a situation where more reps achieve a higher percentage of their bonus. In other cases companies in a low profit situation may want only a small percentage of their reps to exceed their target bonus. Another decision point focuses on the rewards paid to the most successful relative to the least successful reps.

With options available, the next step is to consider what plan ‘type’ is most appropriate. Broadly there are four types; market conditions will determine the best type to adopt and companies will likely have a mix of types - and even variations within type - across their portfolio [Figure 6, overleaf].

TESTING, TESTING

Before signing off the new plan and thinking about the issues around implementation, rigorous testing of the proposed options is undertaken to look at what the payouts would be. This can be done either through simulation or by using historical data.

Using the latter method for example, we can model what would have happened, say last year, if the new proposed plans had been in place.

This not only checks that the new plans are likely to meet a range of goals, but enables the differences between options to be highlighted. It shows in detail:

- The overall cost of the bonus;
- How many reps would meet their bonus;
- The distribution of payouts between the highest and lowest performing reps.

It also helps answer a number of key questions: will it motivate the right behaviours; how ‘fair’ is it; how does it differ from the existing plan; and will we be able to afford it?

This is a powerful and very insightful tool that helps companies assess the likely future impact of the IC change and so make the right choice of plan design that all internal stakeholders (eg, sales, finance, HR, marketing) - including the sales force - are likely to understand, feel comfortable with and, ultimately, buy into.

### 5. REWARDS DETERMINED BY GREATER NEED FOR SPECIALISATION

- **Medical products and services**
  - High risk: 50/50
  - Moderate risk: 65/35
  - Moderate risk: 80/20
  - Low risk: 90/10

- **Institutional reps – hospitals/GPO**

- **Growth markets**

- **Mature market with a lot of managed care control**
STEP 3 - SETTING GOALS
As well as enhancing organisational performance, goal-setting enables companies to align their people objectives with their business strategy and then to reward individuals and/or teams for their specific, measurable and quantifiable contribution to these objectives.

Goal-setting also serves to focus people’s minds, behaviours and activities across the organisation. This collective effort can itself achieve a great deal – particularly when it also leads to shared or common objectives for groups or individuals.

Furthermore, through the goal-setting process, people get to know which territories, products and behaviours are deemed to be the most important to the business. In this way the most ‘important’ things should receive the most attention, and less time should be spent on activities generating outcomes perceived to be of lesser value.

In short, through goal-setting, people and teams get to know exactly what is expected of them when they need to – before the beginning of the financial year.

The benefits to be derived from setting goals can, however, be put at risk if the objectives set are not defined and communicated in a SMART way: specific; measurable; achievable (given the current and foreseen business, economic, legal and regulatory environment); realistic (given the skills and experience of the employee); and time bound.

BEST PRACTICE
The approach we adopt at IMS for goal-setting engagements with our clients follows a similar logic to our approach for plan design, but is less complex [Figure 7].

Our approach to goal-setting is as follows:
1. Situation analysis and definition of requirements
2. Understand territory level historic relationships
3. Develop goal-setting options
4. Testing of options
5. Decision on methodology and implementation.

THE GOAL-SETTING FRAMEWORK
Step one typically involves a series of stakeholder workshops and discussions. From these events, and arising out of the company’s marketing and sales strategy, the key brands to be driven forward are identified and highlighted within the goal-setting framework. Weightings, determined by the relative strategic importance of each brand, will also be proposed. These will then be reflected in how much bonus is eventually allocated to the pursuit of each brand’s target.

‘Hard’ revenue-based or growth-based brand objectives are not, however, the only element within the typical framework. Companies wanting to develop certain processes, shift culture or foster particular behaviours, may also choose to target qualitative components within the framework. As well as setting goals for the individual, goals may also be set for the sales team as a whole.
It’s also worth stressing that any goals set should be perceived as fair and reasonable by the reps. These are key success criteria that rank alongside the need to express goals in a SMART way.

OPTIONS - THE GOAL-SETTING PROCESS
Goals do not have to be set using a top-down, centralised approach that may start with a headline revenue goal for a brand, for example, which is then divided between the reps in some formulaic way. Some companies chose to adopt more of a ‘bottom-up’ approach or use some hybrid model that combines the two.

In the more participative models of goal-setting what might happen is that the national objective is broken down into regional goals by the corporate centre and then teams within the region negotiate how this is then further split across the territories. The advantage of this mixed top-down, bottom-up system is that the teams begin to take ownership of what happens.

A variation on this negotiated model occurs where reps are given their personal objectives centrally but have the opportunity to negotiate a lower target if they felt that the one put forward is too demanding, or indeed a higher one if they felt they could achieve more.

Alternative participative models include a pure bottom-up approach. Here no national objective is announced, rather individuals/teams determine their own objectives and these are aggregated to create a regional or national target.

In a survey conducted by IMSin 2007, some 72 per cent of company respondents said they set objectives primarily from the centre. This included 30 per cent of respondents who said they used a hybrid approach. Only around 10 per cent said they set objectives using a decentralised approach.

WHICH MODEL IS BEST?
Each of the approaches described has benefits and disadvantages. For example, a top-down approach is typically easier to manage, as it is more transparent and fair.

On the downside, the level of engagement between management and the sales force is not as great as it would be if the sales team was to set the objectives itself or negotiate them. Ultimately, of course, companies will opt for a model that not only delivers the strategic goals but one that also fits their managerial culture and structures.

The fundamental question is whether a new goal-setting process can improve on the one it replaces. Coming out the initial diagnostic phase, for example, will be a comparison of the objectives set versus those realised.

IMPLEMENTATION
Implementation requires a series of regular, periodic reviews that track and report on progress made by the sales reps towards their goals. This can be done on a quarterly or even monthly basis but inevitably entails a considerable amount of administration and report generation [Figure 8, overleaf].

In January 2008, IMS entered into a partnership agreement with Callidus Software - a leading supplier of specialist sales performance management software - to
help clients track and handle all the data and reporting associated with this. From these data, forecasts can be made about whether reps are likely to hit their targets. Such forecasts provide a powerful early warning system that enables timely interventions to be made by managers with those reps who are off-course, and lessons to be learned from those performing well above the average.

SUMMARY
Significant rewards are available to those who deploy well designed and administered plans including:
• Strategic alignment which means that compensation plans reflect, promote and focus on market strategies
• A set of balanced objectives that motivate appropriately and reward key soft behaviours, for example, relationship building and team selling that focus on customer needs
• Clarity and fairness which means the sales force understands fully and accepts its IC programme, and can easily track progress and performance during the year
• Improved retention rates among high performing team members that save on recruitment and training costs
• Financial efficiencies from eliminating overpayments to the sales force
• Improved levels of morale from a reduction in the number of disputes caused by underpayments.

A range of factors highlighted in this article demonstrate that IC is becoming a hot topic. Don’t be left out in the cold.

To learn more about the way in which IMS can help you to develop effective incentive compensation plans, please contact David Ziedman at DZiedman@nl.imshealth.com

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